



CHILD and ADULT CARE FOOD PROGRAM
FNS INSTRUCTION 796-2, Rev. 3
Listing of Brochures

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Additional Information:

United States Department of Agriculture
Uniform Federal Assistance Regulations,
7 CFR Parts 3016, 3019, and 3052.
www.gpo.gov/nara/cfr/index.html

United States Department of Agriculture,
Child and Adult Care Food Program
Regulation, 7 CFR Part 226.
www.usda.gov/cnd

United States Department of Agriculture,
Food and Nutrition Service, Instruction
796-2, Rev. 3, Financial Management -
Child and Adult Care Food Program.

Office of Management and Budget
Circulars: A-87, August 29, 1997; A-102,
March 11, 1988; A-110, November 29,
1993; A-122, June 1, 1998; and A-133,
June 24, 1997.

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United States General Services
Administration, Federal Acquisition
Regulations, 48 CFR Part 31.

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**CHILD and
ADULT CARE
FOOD PROGRAM**

**FNS INSTRUCTION
796-2, Rev. 3**

1

**GENERAL
INFORMATION**

*This is the first in a series of brochures on
FNS Instruction 796-2, Revision 3.*

CHILD AND ADULT CARE FOOD PROGRAM (CACFP)

USDA provides CACFP funds to State agencies through grants and other means, to initiate, maintain and expand nonprofit food service programs to children and adult participants.

FNS INSTRUCTION 796-2

FNS Instruction 796-2 provides financial management information and guidance to State agencies, Regional Offices and institutions participating in the CACFP.

HISTORY

FNS Instruction 796-2, Financial Management, was first issued in 1980. Revision 1 was issued in 1983, Revision 2 in 1994 and Revision 3 in 2001.

CAUSE FOR REVISION

The most recent revision to FNS Instruction 796-2 results from changes in:

- Office of Management and Budget Grant and Cooperative Agreement, Cost Principle and Audit Circulars;

- Federal Acquisition Regulations 48 CFR Part 31, Contract Cost Principles and Procedures;
- CACFP legislation and regulations (7 CFR Part 226); and
- Departmental regulations (7 CFR Parts 3015, 3016, 3019, 3052).

Additional changes made to the Instruction reflect the Department's commitment to improve the integrity of the CACFP through comprehensive guidance.

PURPOSE

FNS Instruction 796-2, Revision 3 establishes standards, principles and guidelines for financial management to:

1. Assure the costs charged to the nonprofit food service are allowable, necessary and reasonable for effective and efficient program operations.

2. Assist State administering agencies and institutions in developing and maintaining financial management systems that comply with CACFP requirements.

3. Provide, to the extent possible, all institutions of similar type doing the same work, with the same requirements.

CONTENTS

FNS Instruction 796-2, Revision 3 consists of 12 Parts and 8 Exhibits:

- I. Purpose
- II. Authority
- III. Abbreviations
- IV. Scope
- V. Definitions
- VI. Monitoring Nonprofit Food Service Status
- VII. Basic Guidelines for Determining Allowability of Costs
- VIII. Standards for Allowable Costs
- IX. Basic Guidelines for CACFP Payments and Use of Funds
- X. Food Donation
- XI. Implementation
- XII. Office of Management and Budget Approval

Exhibits:

- A. Glossary
- B. Food Cost
- C. Index
- D. Recording Equipment and Depreciation Format
- E. Cost of Goods Used Format
- F. Purchases Record Format
- G. Inventory Reconciliation Format
- H. Inventory Record Format

NOTE: Consult 796-2, Rev. 3 and the appropriate administering agency for more information.

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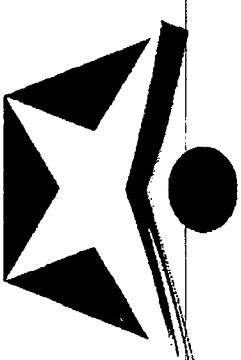
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796-2, Rev. 3**

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ALLOWABLE COSTS

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Allowable costs are bona fide obligations of the institution for the necessary and reasonable expenses that result from performing program functions.

The decision that a cost is reasonable is a judgment made using the prudent person standard. Consideration is given to:

Are there additional factors for allowable costs beyond necessary and reasonable?

Yes. An allowable cost is:

What is a bona fide obligation?

A bona fide obligation occurs when the institution has a legal obligation to pay for goods or services.

What is the difference between necessary and reasonable?

The nature of the activity is used to determine if the cost is necessary, while the amount of the cost to perform that activity is used to decide if the cost is reasonable.

What does "using the prudent person standard" mean?
Given the same circumstances, a sensible person, exercising due care, would spend the same amount of money.
Is the prudent person standard the only factor to use when determining if a cost is reasonable?

- Authorized or at least not prohibited by applicable laws, regulations and 796-2, Rev. 3 and conforms to any limitations or restrictions imposed by these documents;
- A cost of the current period;
- Determined using generally accepted accounting principles;
- Net of all applicable credits;
- Properly allocated; and
- Adequately documented.

How do I decide if a cost is necessary?

A cost is necessary when the activity or function:

No. These additional factors need to be considered:

Program functions result from administrative and operating activities.

- Is generally recognized as ordinary;

Administrative functions occur in planning, organizing and managing the nonprofit food service.

- Required for the institution to operate the program; and

- The constraints imposed by generally accepted sound business practices;
- Arms-length bargaining;
- Significant deviation from established practices;

Operating functions result from the

- Must be accomplished to fulfill regulatory requirements for proper and efficient operation of the program.

preparation and service of meals to participants.

How do I decide if the amount of a necessary cost is reasonable?

- Compliance with Federal and state laws and regulations; and
- The institution acted responsibly.

NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.

Additional Information:

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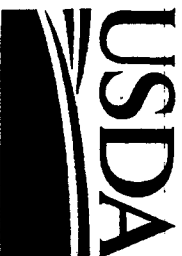
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**# 3
NONPROFIT FOOD
SERVICE**

*This is the third in a series of brochures
on FNS Instruction 796-2, Revision 3.*

All institutions participating in the Child and Adult Care Food Program (CACFP) must operate a nonprofit food service principally for the benefit of its enrolled participants.

What is a nonprofit food service?

Operating a nonprofit food service requires that all revenue received or accruing to the food service is restricted and used only for allowable costs. Any revenue in excess of expenses is used only to maintain, expand or improve the institution's nonprofit food service for its participants.

An institution does not need to lose money or just break even to operate a nonprofit food service; nor is a food service nonprofit just because it is operated by a public institution or the institution earns the lesser of CACFP rates or cost.

What are the requirements for the different types of institutions?

All institutions participating in the CACFP must operate a nonprofit food service principally for the benefit of its enrolled participants.

The institution must meet the nonprofit food service requirement when the institution is:

- An independent child care center;
- A sponsor of affiliated centers;
- A family day care home sponsor.

When the institution sponsors unaffiliated centers, the institution is required to assure

that these unaffiliated centers operate a nonprofit food service.

Family day care homes are exempt from the nonprofit food service requirement.

Are there other activities that must be considered when determining nonprofit food service?

Yes. When the food service is used for other activities, then the nonprofit food service is limited to the food service for the enrolled CACFP participants. Other activities include catering, serving or selling meals to others.

Who identifies the nonprofit food service?

Both the institution and State agency share responsibility for identifying the nonprofit food service. However, the State agency makes the final determination. The institution must describe its food service operations to the State agency during the application process and maintain records that accurately reflect the operation of its food service. The State agency evaluates the information on the application and uses on-site reviews to assess the scope of the institution's food service activities.

What does the State agency review?

The State agency identifies all of the institution's food service activities and reviews financial information, including:

- Nonprofit food service revenues;
- Allowable net nonprofit food service expenses; and

- All income to the program.

The State agency computes the nonprofit food service account balance by deducting net allowable expenses and program income from nonprofit food service revenue. When revenue exceeds expenses, the State agency verifies that this excess revenue is retained and used only in the nonprofit food service program.

What are the institution's responsibilities?

The institution must maintain records identifying all of its food service activities; retain all nonprofit food service revenue in a restricted account; use the nonprofit food service account only for allowable costs; correct any deficiencies identified by the State agency; and implement corrective action when the State agency determines an excessive nonprofit food service account balance exists.

What is an excessive balance?

Each State agency determines what is an excess balance and the specific corrective actions that the institution must take to reduce the balance. An excess balance can only be used to expand or improve the nonprofit food service for the participants and cannot be used for other purposes.

NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.

Additional Information:

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**# 4
APPROVAL
REQUIREMENTS**

*This is the fourth in a series of brochures on
FNS Instruction 796-2, Revision 3.*

Prior approval means securing the State agency's, or in some cases FNS', written permission, in advance, to incur costs.

What costs require prior approval?

All Child and Adult Care Food Program (CACFP) costs require some form of prior written approval.

Are there any exceptions?

In emergencies, State agencies may grant verbal prior approval.

Are there different types of prior approval?

Yes. The requirements vary depending on whether the cost is:

- Generally allowable;
- Requires prior approval; or
- Requires specific prior written approval.

What is a generally allowable cost?

Generally allowable costs occur in the routine operation of the CACFP.

What are the prior approval requirements for generally allowable costs?

An institution must include these costs in the budget submitted to the State agency. These costs are approved through the annual management plan and budget approval process.

What is the difference between a cost that

requires prior approval and one that requires specific prior written approval?

A cost that requires prior approval is an allowable cost but due to either the nature or amount of the cost, written prior approval is required.

Costs requiring specific prior written approval are costs that are not customarily incurred in the routine operation of the CACFP but can sometimes be necessary and reasonable for proper and effective Program operations.

What are the requirements for costs requiring prior approval?

The institution must specifically identify the cost item and amount during the budget submission process. Including the cost as part of a larger entry in a budget line item without identifying the cost item and amount is not sufficient and will not meet the requirement for adequate disclosure. When these cost items and amounts are properly disclosed, approval of the budget meets the requirement for prior approval unless the State agency specifically disallows the cost in writing.

What are the requirements for costs requiring specific prior written approval?

The institution must specifically identify and request approval of these costs during the annual budget approval process or submit a separate request to the State agency. Approval of a budget line item does not constitute adequate specific prior written

approval for these costs. Whether submitted during the budget approval process or separately, the State agency must approve or deny the requested cost in writing.

Is there a timeframe in which the State agency must approve or disapprove the institution's request for specific prior written approval?

Yes. Since a cost requiring specific prior written approval is an amendment to the institution's budget, the timeframes established at §226.6(b)(10) apply. The State agency must approve or deny a complete and correct request within 30 days of receipt.

Can the institution appeal the denial of a cost?

Yes, when the denial will affect the institution's claim for reimbursement or participation.

What must a State agency do when an institution does not request specific prior written approval before incurring the cost?

The cost must be disallowed.

Does approval of a cost guarantee funding?

No. Approval of cost is never a guarantee of funding.

NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.

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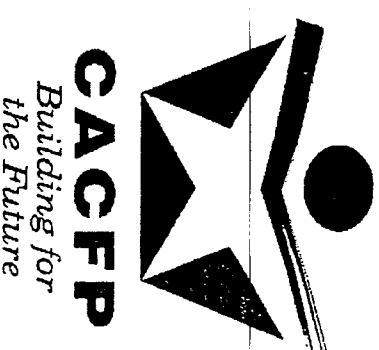
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**CHILD and
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**FNS INSTRUCTION
796-2, Rev. 3**

**# 5
ALLOWABLE
LABOR COSTS**

*This is the fifth in a series of brochures on
FNS Instruction 796-2, Revision 3.*

<p>Allowable labor costs are the necessary and reasonable costs that result from performing program administrative and operating functions.</p>	<ul style="list-style-type: none"> • The skill, experience and education level of the employee performing the activity; • The conditions of the market place; and • Whether the cost is consistent with the amount paid by the institution or others for similar non-Federal work. 	<ul style="list-style-type: none"> • Any payment for services or benefits to individuals not employed by the institution, except for certain family health care benefits;
<p>What is the difference between administrative and operating labor?</p>	<p>What resources are available to compare labor compensation costs?</p>	<ul style="list-style-type: none"> • Compensation that is inconsistent with the institution's written compensation policy; • Retroactive salary or wage increases; • Increases solely to maximize available reimbursement; • Compensation in any form based on the number of homes recruited; • Noncompliance with Federal and State employment compensation or taxation requirements; • Compensation in any form to repay debts, overclaims or disallowances; and • Labor costs that are not determined and documented in accordance with Generally Accepted Accounting Principles (GAAP) and FNS Instruction 796-2 or the State equivalent.
<p>Administrative labor includes planning, organizing and managing the nonprofit food service, while operating labor includes the preparation and service of meals to participants.</p>	<p>A variety of resources are available including:</p> <ul style="list-style-type: none"> • U.S. Department of Labor, Bureau of Labor Statistics; • State Department of Labor; • State & local unemployment commissions; • For public institutions, the pay scale for similar occupations; and • Classified ads and Internet job sites. 	
<p>What is a necessary labor cost?</p> <p>A labor cost is necessary when the activity or function:</p> <ul style="list-style-type: none"> • Is generally recognized as ordinary; • Is required for the institution to operate the program; and • Must be accomplished to fulfill regulatory requirements for proper and efficient operation of the program. 	<p>What are the general guidelines for determining allowable labor costs?</p> <ul style="list-style-type: none"> • Each element of compensation is reasonable in relation to the services provided; • The compensation conforms to the institution's written compensation policy; • The compensation is for program work performed during the current period; and • The compensation is earned and paid to individuals employed by the institution. 	<p>Where can I find more information on the different categories of labor costs?</p> <p>For a quick reference, please refer to CACFP Brochure # 6, <i>Labor Cost Categories</i>. For detailed information, refer to FNS Instruction 796-2, Rev. 3.</p>
<p>How do I decide if the amount of a necessary labor cost is reasonable?</p>	<p>The decision that a cost is reasonable is a judgment made using the prudent person standard. Consideration is given to:</p> <ul style="list-style-type: none"> • The institution's needs; • The institution's financial condition, i.e., can the institution afford to incur the cost; 	<p>Are there any labor costs that are unallowable?</p> <p>Yes. Unallowable labor costs include:</p>
		<p><i>NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.</i></p>

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LABOR COST
CATEGORIES

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Labor costs include all forms of compensation earned and all forms of payment made either in cash or noncash for personal services.

What are the elements or categories of labor costs?

- Salaries and Wages;
- Overtime, Holiday Pay and Compensatory Time;
- Fringe Benefits;
- Employment Taxes;
- Incentive Award Payments; and
- Severance Pay.

Should all employees performing the same work receive the same level and types of compensation?

Yes. Except for differences resulting from longevity, employees performing the same work within an institution should receive the same compensation.

Are all payments made to individuals that perform program duties included in labor costs?

No. Only the payments made to the institution's employees are classified as labor costs. Costs for contracted labor are contract costs.

Are benefits paid only to certain employees allowable?

The costs can be allowable when:

- The benefits are provided equally to the same class of employees; and
- The benefits are paid consistent with the institution's written compensation policy.

What is in a written compensation policy?

A written compensation policy includes every element of compensation earned by an employee. This written policy, which is usually part of the institution's larger set of personnel policies, establishes the way the institution's employees earn compensation and the way in which the institution will pay that compensation.

What is compensatory time?

Compensatory time is paid time off in lieu of paid overtime. Federal and State labor laws exempt certain employees from receiving overtime compensation. Some organizations provide compensatory time for exempt employees.

What are some examples of allowable fringe benefits?

- Paid vacation, military and sick leave;
- Health and retirement benefits; and
- Disability and life insurance.

Are family health benefit plan costs allowable?

Yes, to the extent the employee's salary on which the benefits are earned is allowable.

Is the employee's share of employment

taxes allowable?

No, only the employer's share is allowable.

What are allowable forms of incentive awards?

- Cash;
- Additional paid vacation; and
- Minor value awards such as pins, plants, etc.

When is severance pay allowable?

When the payment is required by:

- Law;
- Written employer-employee agreement; or
- A labor relations agreement.

Can an institution claim the cost of fringe benefits and incentive awards provided to contractors?

No. Allowable fringe benefit and incentive award costs are limited to employees.

Do the same rules apply to each of these elements of labor cost?

While costs for each of these elements must be necessary and reasonable, specific requirements apply to each of these elements.

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ADULT CARE
FOOD PROGRAM**

**FNS INSTRUCTION
796-2, Rev. 3**

7

**EQUIPMENT
PURCHASES and
DEPRECIATION**

*This is the seventh in a series of brochures
on FNS Instruction 796-2, Revision 3.*

Instead of using depreciation, an institution can be permitted to charge the program for the cost of certain types of equipment and improvements at the time the items are purchased or when improvements are made. When the cost of equipment is not charged (expensed) at the time of purchase, the item can be depreciated.

- Reproduction and printing equipment;
- Motor vehicles; and
- Automated data processing equipment used for both program and general administrative purposes.

How is equipment depreciation computed?

Depreciation is computed using the useful life and net cost of the equipment. Only the non-Federally funded share of the net cost can be depreciated. When the equipment is used for program and nonprogram purposes, the amount of depreciation must be prorated.

What is the current definition of equipment?

Equipment is an item of nonexpendable personal property with a useful life of more than 1 year and an acquisition cost of \$5,000 or more per unit. When an institution has a more conservative definition for equipment, the institution must use that definition to identify equipment.

Except for automated data processing equipment, the institution can expense the prorated program share of the cost of the equipment. The institution must pay for the nonprogram share from sources other than the institution's nonprofit food service account.

What methods of depreciation can be used?

The institution can use either a 15 year straight line depreciation method or the method used and accepted for Federal income tax reporting purposes. All other methods require specific prior written approval by the State agency.

How is an item classified if it does not meet this definition?

The item is classified as a supply.

Does expensing an item of equipment require prior approval?

Yes. Specific prior written approval by the State agency is required.

When can a use allowance be taken?

A use allowance may be taken as an expense for equipment when the item was originally purchased with non-Federal funds and after it has been fully depreciated. At that point, the Federally funded activity or program may take a use allowance based on a calculated method.

Are there any requirements for purchasing supplies?

Yes. Refer to FNS Instruction 796-2, Rev. 3, Chapter VIII, I, 27, Materials and Supplies.

Are there other requirements that must be followed when equipment is expensed?

Yes. The institution must comply with Federal property management and disposition requirements.

What kinds of equipment can be expensed?

Most equipment purchased by the institution that is used in the Program can be expensed, except for the following:

- Equipment purchased by individuals;
- Donated equipment;
- General purpose equipment, including office equipment and furnishings;
- Air conditioning equipment;

Where can I find these requirements?

Refer to 7 CFR Part 3016.31-.33 for public institutions and 3019.30-.37 for nonprofit institutions for information on recordkeeping, transfer and disposition instructions. Exhibit D of FNS Instruction 796-2, Rev. 3 can be used to meet the recordkeeping requirements.

Can an institution remove funds from its nonprofit food service account when depreciation is used?

No. Depreciation is a non cash transaction. Depreciation is not a contingency or equipment replacement fund. It is a method used to recognize that a benefit has been derived from using an asset supplied by the institution.

Does the State agency have the right to disapprove a request to expense equipment?

Yes. In these cases, the institution can depreciate the program share of the equipment's cost.

NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.

Additional Information:

United States Department of Agriculture
Uniform Federal Assistance Regulations,
7 CFR Parts 3016, 3019, and 3052.
www.gpo.gov/nara/cfr/index.html

United States Department of Agriculture,
Child and Adult Care Food Program
Regulation, 7 CFR Part 226.
www.usda.gov/cnd

United States Department of Agriculture,
Food and Nutrition Service, Instruction
796-2, Rev. 3, Financial Management -
Child and Adult Care Food Program.

Office of Management and Budget
Circulars: A-87, August 29, 1997; A-102,
March 11, 1988; A-110, November 29,
1993; A-122, June 1, 1998; and A-133,
June 24, 1997.

www.whitehouse.gov

United States General Services
Administration, Federal Acquisition
Regulations, 48 CFR Part 31.

www.gsa.gov

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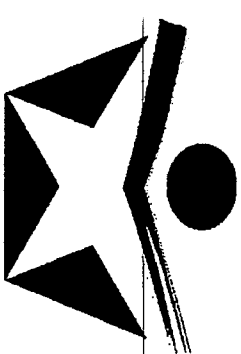
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**FNS INSTRUCTION
796-2, Rev. 3**

**# 8
LEGAL SERVICES
COSTS**

*This is the eighth in a series of brochures on
FNS Instruction 796-2, Revision 3.*

Special situations and general day-to-day operations can result in an institution incurring legal expenses. In some cases, these legal costs are allowable, while in others, the costs are unallowable.			
What types of legal costs are allowable?	With specific prior written approval of the State agency, costs of the following legal services, when performed by persons who not officers or employees of the institution, are usually allowable:	Are the institution's costs for defending itself against claims and lawsuits initiated by employees, ex-employees or facilities allowable?	What are "all costs?"
<ul style="list-style-type: none"> The sponsoring organization's cost to pursue recovery of funds from sponsored facilities; and The costs of services required in the administration of the Child and Adult Care Food Program (CACFP). 	Generally, the costs are allowable when the institution's actions result from complying with CACFP requirements. However, the costs are not allowable when the institution has violated statutory or regulatory requirements.	<ul style="list-style-type: none"> Can the institution claim legal costs if it prevails in a proceeding commenced by a government agency? 	<p>All costs includes administrative and clerical costs, costs of legal services, professional services other costs of the institution, its employees, officers, directors and trustees.</p> <p>Yes, but allowable costs are generally limited to 80% of the institution's necessary and reasonable expenses.</p>
Are CACFP administrative review costs allowable?	Yes. The institution's costs for administrative reviews pursuant to the CACFP regulations are generally allowable.	What are some examples of unallowable legal costs?	When can a State agency allow an institution to claim legal costs for proceedings commenced by a government agency?
What are some examples of allowable administrative review costs?	<ul style="list-style-type: none"> Costs for in-house or properly procured private counsel; Costs for professional services, such as an accountant or consultant, administrative and clerical services; and Costs of directly related services provided by the institution's employees, officers and trustees as long as these costs are not also claimed as labor or other costs. 	<ul style="list-style-type: none"> The costs of prosecuting claims against the Federal government, however represented; The cost of maintaining a legal staff to discharge general responsibilities; The costs of legal services for organization and reorganization; Fines, penalties, restitution, back pay awards and damage awards; and All costs before, during and after commencement of judicial or administrative proceedings, excluding administrative reviews provided by the CACFP regulations, when the proceeding is initiated by a government agency and relates to a violation of, or failure of the institution, its agents or employees to comply with a statute or regulation. 	<p>Payment of these costs must generally be withheld until after resolution of the proceedings. However, the costs may be claimed and conditional payment made with specific written approval of FNS.</p> <p>Is specific prior written approval always required to claim any legal costs?</p> <p>Yes.</p>
<p>NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.</p>			

Additional Information:

United States Department of Agriculture
Uniform Federal Assistance Regulations,
7 CFR Parts 3016, 3019, and 3052.
www.gpo.gov/nara/cfr/index.html

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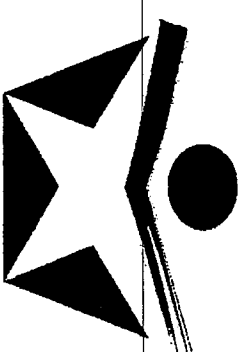
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**FNS INSTRUCTION
796-2, Rev. 3**

**# 9
RENTAL COSTS**

*This is the ninth in a series of brochures on
FNS Instruction 796-2, Revision 3.*

<p>Allowable rental costs are the program share of lease fees for space, facilities, vehicles and equipment used in the program. Allowable rental costs are limited in certain lease arrangements.</p>	<p>Are rental costs allowed when the lease is between an individual and the lessor?</p> <p>No. The institution must be the lessee.</p>	<p>Yes. Reasonable and necessary costs, such as maintenance and custodial costs, can be included in rental fees.</p> <p><u>EQUIPMENT, SUPPLIES and VEHICLES</u></p>
<p>Are there common requirements for all types of rental situations?</p> <p>Yes. The following apply when determining the allowable costs of any rental:</p> <ul style="list-style-type: none"> • A bona fide rental arrangement must exist between the institution and lessor; • The rental must be properly procured and the contractual documents must be adequate; • Rental costs must be reasonable given the needs of the institution, the program, current market conditions and the type, life expectancy, condition and value of the property or item; and • Rental costs must be prorated between program and nonprogram use. 	<p>Can an institution rent from an individual that is an officer, employee or a family member.</p> <p>Yes, but allowable costs are limited and special rules apply to these related party transactions. Refer to FNS Instruction 796-2, Rev. 3, Chapter VIII, I, 36, Rental Costs for complete information. Brochure #9, <i>Special Leases</i>, provides a synopsis of the requirements for determining allowable costs in special lease situations.</p>	<p>Are the requirements different when an institution rents supplies, such as fax or copy machines?</p> <p>No.</p> <p>Can an institution charge a mileage fee and a lease fee for the same vehicle?</p> <p>No, but the program share of fuel costs, insurance premiums, routine maintenance, parking and tolls are allowable costs for leased vehicles.</p>
<p>Can an institution charge a rental fee for space, equipment or vehicles when the item is owned by the institution?</p>	<p><u>SPACE AND FACILITIES</u></p> <p>Is renting space in a private residence allowable?</p> <p>Yes, when a bona fide arms-length rental exists with an independent third party and the program share of the cost is reasonable.</p> <p>Are renovations, rearrangement and alteration costs to rented space allowable?</p>	<p>Can the institution permit officers or employees to use rented vehicles for personal use?</p> <p>Yes, however, the lease fee must be prorated between program and nonprogram use. All personal use operating costs and the nonprogram share of the lease fee, maintenance and insurance costs are</p>
<p>No, however, the institution can usually charge depreciation.</p> <p>Can an institution charge depreciation and a lease fee for the same item?</p> <p>No.</p>	<p>No.</p> <p>Can the lease fees include other costs?</p>	<p>unallowable.</p> <p><i>NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.</i></p>

Additional Information:

United States Department of Agriculture
Uniform Federal Assistance Regulations,
7 CFR Parts 3016, 3019, and 3052.
www.gpo.gov/nara/cfr/index.html

United States Department of Agriculture,
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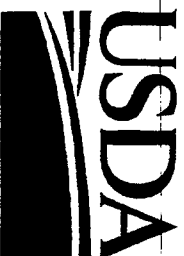
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**CHILD and
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**FNS INSTRUCTION
796-2, Rev. 3**

**# 10
SPECIAL LEASE
COSTS**

*This is the tenth in a series of brochures on
FNS Instruction 796-2, Revision 3.*

Allowable costs are limited in certain rental transactions. Special lease situations can occur in the rental of facilities, equipment and supplies.

What is a special lease?

- Less-than-arms-length;
- Material equity lease (capital leases);
- Sale with lease back; and
- Option to purchase lease.

What is a less-than-arms-length lease?

When one party to the lease is able to control or substantially influence the actions of the other party.

What are some examples of less-than-arms-length leases?

- Leases between the institution and a director, trustee, officer or employee of the institution;
- Leases between the institution and a family member of a director, trustee, officer or employee of the institution;
- Leases between divisions of an organization; and
- Leases between organizations under common control.

When are organizations under common control?

Common control occurs when organizations are under the control of the same individual(s) or when the individual(s) hold a controlling interest in both organizations.

What is a material equity lease?

When the lessee obtains an ownership interest in the leased item. A material equity is created when:

- The lease is non-cancelable or cancelable only upon some remote contingency;
- The item must be purchased if the lease is canceled;
- The purchase price at the end of the lease term appears to be substantially below probable fair market value;
- Title to the item passes to the institution at some time during or after the lease period;
- The term of the lease (initial plus any renewals) is equal to 75 percent or more of the economic life of the leased item; or
- A specific portion of the lease payment is applied to the purchase price of the item, whether or not the purchase option is exercised.

term appears to be substantially below

probable fair market value;

- Title to the item passes to the institution at some time during or after the lease period;
- The term of the lease (initial plus any renewals) is equal to 75 percent or more of the economic life of the leased item; or
- A specific portion of the lease payment is applied to the purchase price of the item, whether or not the purchase option is exercised.

A specific portion of the lease payment is applied to the purchase price of the item, whether or not the purchase option is exercised.

What is sale with lease back?

When an item is sold and then leased back to the seller or an affiliate of the seller. The seller may be an individual or business.

What is an option to purchase lease?

This lease does not create a material equity, but does permit the lessor to purchase the item.

What costs are allowable in special lease situations?

Except for lease with option to purchase, allowable costs are limited to the amount that would have been allowed had the institution purchased or continued to own the item on the date the lease was executed. This amount is computed using the acquisition cost (less the value of land for space and facilities) and following straight line depreciation methods:

- Space and Facilities: 30 year

- Equipment, except automobiles and automated data processing (ADP) equipment: 15 year;
- Automobiles and ADP equipment: 5 year

For option to purchase leases, allowable costs are the lesser of:

- The lease fee;
- The rental cost without the purchase option; or
- The cost to purchase the item including financing costs.

What if the lease fee exceeds the allowable amount?

The excess costs are unallowable. Institutions are not permitted to charge to the program any portion of the rental fee that exceeds the allowable amount.

Must the institution disclose a special lease arrangement to the State agency?

Yes. Special lease arrangements require specific prior written approval. When an institution fails to fully and accurately disclose a special lease, all of the lease costs are unallowable.

NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.

Additional Information:

United States Department of Agriculture
Uniform Federal Assistance Regulations,
7 CFR Parts 3016, 3019, and 3052.
www.gpo.gov/nara/cfr/index.html

United States Department of Agriculture,
Child and Adult Care Food Program
Regulation, 7 CFR Part 226.
www.usda.gov/cnd

United States Department of Agriculture,
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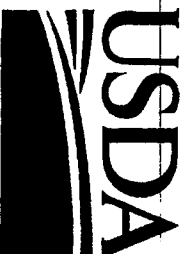
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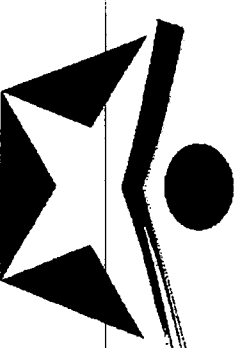
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**FNS INSTRUCTION
796-2, Rev. 3**

11

**INTEREST and
COLLATERAL**

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Interest, fees and charges in lieu of interest can be incurred, as well as earned, on program and nonprogram activities. Institutions, in securing loans or other debt instruments, may be required to provide collateral.

Can institutions retain interest earned on Child and Adult Care Food Program funds?

Institutions may earn and retain interest on advance and reimbursement funds; however, the following rules apply:

Public Institutions:

- May retain up to \$100 in interest earned annually on advance funds; and
- Any interest earned in excess of \$100 must be remitted to FNS through the State agency.

Not-for-profit Private Institutions:

- May retain up to \$250 in interest earned annually on advance funds; and
- Any interest earned in excess of \$250 must be remitted to:

Department of Health and Human Services (DHHS)
Payment Management System
Box 6021
Rockville, Maryland 20852

All Institutions:

- May retain interest earned on reimbursements and pass-through funds to sponsored facilities.

Can an institution use retained interest to repay an overclaim?

No. An overclaim is an unallowable cost. All interest retained by an institution is income to the program. As income to the program, the funds must accrue to the nonprofit food service. Nonprofit food service funds can not be used to pay for unallowable costs.

Are interest charges on loans an allowable cost?

The interest is allowable when the institution obtains a bona-fide third party loan and uses the proceeds to acquire or replace program equipment, other program property or make program improvements.

Is all interest on loans allowable?

No. Unallowable interest expenses include:

- Interest in excess of the actual interest paid;
- Interest for any debt the institution is not legally obligated to pay;
- Interest on debt used to acquire unallowable equipment or other property;
- Interest on borrowed capital or the temporary use of endowment funds;
- Interest for reacquiring equipment or other property held by the institution or a related party;
- Credit card interest debt;
- Costs for failure to pay debt timely;
- Fees and charges in lieu of unallowable interest;
- All interest and principal when a less-than-arms-length financing arrangement was not fully and accurately disclosed to the State agency and FNS; and

- In less-than-arms-length transactions, interest expense in excess of the fair market rate available to the organization from an unrelated third party.

Can an institution use its nonprofit food service resources as collateral to secure a loan?

The following nonprofit food service resources can be used:

- Administrative cost reimbursement payments;
- Reimbursement payments for centers owned and operated as part of the institution; and
- Equipment and other assets that have no current federally funded interest.

The following nonprofit food service resources cannot be used:

- All advance funds;
- Reimbursement payments for sponsored centers not owned by the institution and all family day care homes;
- Equipment or other assets having a Federal interest; and
- Any nonprofit food service account asset when:

- ◆ The loan, in whole or in part, is for nonprogram purposes;
- ◆ The loan is made to an officer, director or employee; and
- ◆ The lender is not a bona fide third party lending institution.

NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.

Additional Information:

United States Department of Agriculture
Uniform Federal Assistance Regulations,
7 CFR Parts 3016, 3019, and 3052.
www.gpo.gov/nara/cfr/index.html

United States Department of Agriculture,
Child and Adult Care Food Program
Regulation, 7 CFR Part 226.
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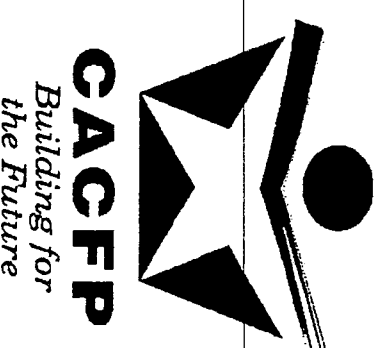
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FNS INSTRUCTION
796-2, Rev. 3

12

PARTICIPANT
SUPPORT COSTS

*This is the twelfth in a series of brochures on
FNS Instruction 796-2, Revision 3.*

<p>Participants are independent and sponsored child care centers and family day care homes, but not sponsoring organizations.</p>	<p><u>Child care center operating costs:</u></p> <ul style="list-style-type: none"> • The cost for center employee substitutes when the training is conducted during the facility's established hours of program operations; and 	<p>Yes, when all Program requirements are met.</p> <p><u>What costs are allowable for appeals?</u></p> <p>Allowable costs can include:</p> <ul style="list-style-type: none"> • In-house or properly procured private counsel; • Professional services, such as an accountant, consultant or independent hearing official; • Administrative and clerical services, including recording and transcription services; and • Costs for properly procured meeting room space.
<p>What are participant support costs?</p> <ul style="list-style-type: none"> • Pre and post Program approval training for facilities; and • Facility fair hearing costs. 	<ul style="list-style-type: none"> • Travel and transportation costs for employees required to attend training. 	
<p>What are allowable participant training costs?</p>	<p>Are day care home provider travel and transportation costs to attend training allowable?</p>	
<p><u>Administrative costs:</u></p> <ul style="list-style-type: none"> • Rental costs for meeting rooms; • Fees for speakers who are not officers, employees, family members, etc.; • Child care services for attending facility personnel; • Costs for meals and nonalcoholic beverages served to participants, but not to guests, when Program training is presented concurrent with the meal service; and • Training materials, supplies and incidental expenses. 	<p>Is the cost for substitutes for day care home providers allowable?</p> <p>No.</p> <p>What are other unallowable participant training costs?</p> <ul style="list-style-type: none"> • Costs for motivational speakers; and • Costs of social events, entertainment, flowers, table decorations, alcoholic beverages, door prizes and gifts. 	<p>Are allowable facility appeal costs operating or administrative costs?</p> <p>Administrative.</p> <p>What other participant support costs are allowable?</p> <p>None.</p>

NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.

Additional Information:

United States Department of Agriculture
Uniform Federal Assistance Regulations,
7 CFR Parts 3046, 3049, and 3052.

www.gpo.gov/nara/cfr/index.html

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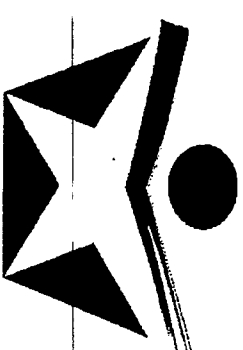
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796-2, Rev. 3, Financial Management -
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**CHILD and
ADULT CARE
FOOD PROGRAM**

**FNS INSTRUCTION
796-2, Rev. 3**

14

**DISCLOSURE
REQUIREMENTS and
SPECIAL
CONSIDERATION**

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*This is the fourteenth in a series of brochures
on FNS Instruction 796-2, Revision 3.*

<p>Some costs require more disclosure than others. FNS Instruction 796-2, Rev. 3 establishes three cost approval categories based on the amount of disclosure required.</p>	<p>When the State agency determines that the failure was not deliberate, the institution may be permitted to claim and retain Child and Adult Care Food Program (CACFP) funds up to the amount that would have been allowed had full and accurate disclosure been provided. However, the institution can never be permitted to claim unallowable costs, retain program funds earned as a result of claiming unallowable costs or use nonprofit food service account funds to pay for unallowable costs.</p>	<p>Yes, but the costs must be specifically identified by item and amount.</p>
<p>Why do certain costs require more disclosure than others?</p>	<p>What are the three approval categories in FNS Instruction 796-2, Rev. 3?</p>	<p>What are the procedures for specific prior written approval?</p>
<p>Depending on the circumstances, a cost may be allowable, partially allowable or unallowable. A State agency cannot fulfill its regulatory responsibility to approve only allowable costs without the institution providing sufficient information.</p>	<ul style="list-style-type: none"> • Generally allowable costs; • Costs requiring prior approval; and • Costs requiring specific prior written approval. 	<p>The institution must specifically identify and request approval of these costs before the costs are incurred. The institution's request can be submitted during the annual budget approval process or separately. The State agency must approve or deny these specific requests in writing.</p>
<p>How does an institution satisfy disclosure requirements?</p>	<p>What costs are generally allowable?</p>	<p>What is a cost requiring special consideration?</p>
<p>The State agency must inform the institution how to satisfy the disclosure requirements of FNS Instruction 796-2, Rev. 3.</p>	<p>Generally allowable costs occur in the routine operation of the CACFP.</p>	<p>Special consideration exists whenever a transaction lacks independence or the integrity of the transaction could be compromised. When a special consideration exists, specific prior written approval is required.</p>
<p>What are the obligations of an institution regarding disclosure?</p>	<p>What costs require prior approval?</p>	<p>What are some examples of special consideration?</p>
<p>An institution must comply with State agency disclosure requirements and provide any additional information the State agency needs to make an informed decision on the allowability of the institution's budgeted or claimed costs.</p>	<p>These are costs that, by type or amount, require additional disclosure for the State agency to make an informed decision about allowability.</p>	<ul style="list-style-type: none"> • All less-than-arms-length transactions; • Compensation to members of nonprofit institutions, trustees, directors, associates, officers or their immediate families; and • All special lease arrangements.
<p>Are there certain costs that always require disclosure?</p>	<p>What costs require specific prior written approval?</p>	<p>Where can I find more information about special lease arrangements?</p>
<p>Yes. Related party transactions, less-than-arms-length transactions, ownership interests in equipment, supplies or facilities and costs requiring special consideration must be disclosed.</p>	<p>These are costs that are not customary in the routine operation of the CACFP but may still be necessary and reasonable in a specific situation.</p>	<p>For quick reference, refer to Brochure # 10, <i>Special Lease Costs</i>. For more detailed information, refer to FNS Instruction 796-2, Rev. 3.</p>
<p>What are the penalties for failing to provide adequate disclosure?</p>	<p>Are generally allowable costs included in the budget?</p>	<p>NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.</p>
<p>Failing to disclose required information will result in the disallowance of the cost and may subject the institution, its principals, employees and others to the administrative and legal remedies available to the State agency and FNS.</p>	<p>Yes. An institution must still include these costs in the budget submitted to the State agency. Approval of the budget results in the approval of these costs.</p>	
<p>What happens when the failure to disclose was unintentional?</p>	<p>Can costs requiring prior approval be included in the budget?</p>	

Additional Information:

United States Department of Agriculture
Uniform Federal Assistance Regulations,
7 CFR Parts 3016, 3019, and 3052.
www.gpo.gov/nara/cfr/index.html

United States Department of Agriculture,
Child and Adult Care Food Program
Regulation, 7 CFR Part 226.
www.usda.gov/cnd

United States Department of Agriculture,
Food and Nutrition Service, Instruction
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Office of Management and Budget
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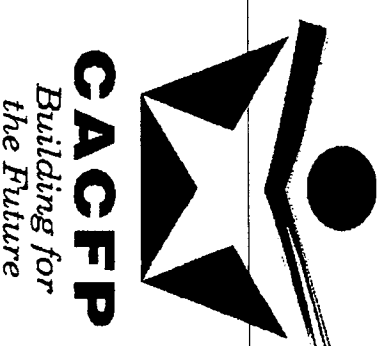
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**CHILD and
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**FNS INSTRUCTION
796-2, Rev. 3**

15

**DIRECT COSTS,
INDIRECT COSTS and
COST ALLOCATION**

*This is the fifteenth in a series of brochures on
FNS Instruction 796-2, Revision 3.*

Costs are either direct or indirect. Due to differences in activities and accounting practices, a cost may be direct in one institution and indirect in another.

What are direct costs?

Direct costs benefit allowable and unallowable activities and can be easily identified with a specific function or activity.

What are some examples of allowable direct costs?

In the Child and Adult Care Food Program (CACFP), allowable direct costs benefit administrative or operating functions or a combination. Examples include:

- Operating and administrative nonprofit food service employee salaries;
- Depreciation or use allowances on equipment used in the nonprofit food service program; and
- Food purchased for use in the nonprofit food service program.

What are indirect costs?

Indirect costs benefit more than one function or activity but cannot be easily identified or assigned. Indirect costs can benefit both allowable and unallowable activities. Examples include:

- Depreciation and use allowances on buildings and equipment used for common purposes;
- Costs of operating and maintaining facilities; and
- Salaries for an office receptionist and central accounting staff.

How are direct and indirect costs assigned to the CACFP?

Direct costs are assigned to the activity that receives benefit from the cost, while indirect costs are allocated on a consistent and rational basis to assign a share of the costs to each activity that benefits from the cost.

How is a direct cost that benefits more than one activity assigned?

When more than one activity benefits from a direct cost, the cost must be allocated. The allocation method assigns a share of the direct cost to each activity based on the benefits received, not the source of funds available to pay for the cost. The institution must provide the State agency with the method it will use to assign these shared costs and the State agency must provide specific prior written approval of the allocation method.

How are indirect costs assigned?

Indirect costs are assigned on a consistent and rational basis according to the State agency's financial management system and are subject to review by FNS. Indirect costs are frequently assigned through an indirect cost rate.

What is an indirect cost rate?

An indirect cost rate is a mathematical relationship between indirect costs and direct costs.

How is an indirect cost rate calculated?

An indirect cost rate is developed through a cost allocation plan (CAP). Using audited cost information, the CAP identifies and assigns the costs as direct and indirect. The indirect cost rate is computed by dividing the indirect costs by a direct cost base.

What is a direct cost base?

A direct cost base is the sum of all allowable and unallowable direct costs that receive benefit from the indirect costs.

Can a predetermined amount such as 10% be used as the indirect cost rate?

No. The indirect cost rate must be computed usually a CAP developed from actual audited cost data. Either the cognizant Federal agency or the State agency must approve the CAP and the rate.

When does a Federal agency approve the CAP and indirect cost rate?

Federal agency approval is generally limited to public organizations receiving Federal funds from more than one source. Federal agency approval is also available on a very limited basis for certain very large not-for-profit organizations.

Where can an institution obtain information on how to prepare a CAP?

The institution must use OMB Circulars A-87 and A-122 and Federal Acquisition Regulations 48 CFR Part 31, as applicable, when developing a cost allocation plan. An institution should contact its State agency for additional guidance.

Where can an institution learn more about direct and indirect costs in the CACFP?

An institution should contact its State agency for additional information and consult FNS Instruction 796-2, Rev. 3.

NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.

Additional Information:

United States Department of Agriculture
Uniform Federal Assistance Regulations,
7 CFR Parts 3016, 3019, and 3052.
www.gpo.gov/nara/cfr/index.html

United States Department of Agriculture,
Child and Adult Care Food Program
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**INCOME TO THE
PROGRAM**

*This is the sixteenth in a series of brochures
on FNS Instruction 796-2, Revision 3.*

All income to the program must be retained and used in the institution's nonprofit food service account.

Are there different categories of income to the program?

software developed to prepare Program claims for reimbursements, gross income from the sale of cookbooks for use in the program, training materials and rental fees or income from videos developed with Program funds.

Institution's must account for two different categories of income to the program, Program income and other income.

What is other income?

Other income includes other funds that result from program operations or are applied to program operations.

What is Program income?

Program income is the gross income earned from activities supported by the program. When the institution's nonprofit food service includes all of its food service activities, program income is generated by the operation of any aspect of that food service. When the institution's program food service is limited to the Child and Adult Care Food Program (CACFP), Program income is limited to the income that results from operating the CACFP. If an institution incurs costs to produce the Program income but does not charge these costs to the program, these costs may be subtracted from gross income to determine net Program income.

What are some examples of other income?

- Cash donations specifically earmarked for use in the program food service.
- Cash that is not earmarked but used in the nonprofit food service, except certain loans and internal transfers;
- Interest earned on CACFP funds (reimbursement, advance administrative, meals service and facility pass-through funds) that can be retained by the institution;
- Funds committed by the institution to the program;
- Funds received for program food service activities from any other Federal, State, intermediate or local government source; and
- Funds received from the sale of unused or unneeded supplies purchased with Program funds.

What are some examples of Program income?

- Participant payments for meals in institutions which operate pricing programs;
- Payments received from food sales to adults;
- Revenue from nonprogram operations when a separation of program and nonprogram food service is not appropriate;
- Proceeds from the disposition of real and nonexpendable personal property acquired with FNS funds; and
- Royalties and other income earned from the sale or licensing of copyrighted work developed under the Program. Examples include license fees for

Are there any funds that are always excluded as income to the program?

- Yes. The following is never classified as Program or other income:
- Internal transfers of funds pursuant to the institutions funds management policy, to meet cash flow needs;

- Bona fide third party short term loans to meet cash flow needs;
- Revenues raised by a public recipient under its governing powers, such as taxes, special assessment, levies and fines unless specifically raised for use in the institution's program food service; and
- Interest earned on CACFP advance funds that must be returned.

How is income to the program to be treated when determining nonprofit food service?

In all cases, income to the program must be used to reduce the amount of CACFP program costs. For example, if the institution spent (expensed) \$1,000 and also collected \$100 in program income, then the institution's net expenses would be \$900.

Specifically, Program and other income can only be used for allowable program purposes by:

- Deducting the income from CACFP costs in center programs reimbursed on the basis of the lesser of meals times rates or cost;
- Deducting the income from CACFP day care home sponsor administrative costs to determine net reimbursable administrative costs; and
- Deducting the income from allowable program food service account expenses in centers reimbursed using the rate-based method when determining if the institution is operating a nonprofit food service account.

NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.

Additional Information:

United States Department of Agriculture
Uniform Federal Assistance Regulations,
7 CFR Parts 3046, 3049, and 3052.
www.gpo.gov/nara/cfr/index.html

United States Department of Agriculture,
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**FNS INSTRUCTION
796-2, Rev. 3**

**# 17
INDEX**

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for costs contained in FNS Instruction
796-2, Rev. 3.

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**NOTE: Consult 796-2, Rev. 3 and the
appropriate administering agency for more
information.**

Additional Information:

United States Department of Agriculture
Uniform Federal Assistance Regulations,
7 CFR Parts 3016, 3019, and 3052.
www.gpo.gov/nara/cfr/index.html

United States Department of Agriculture,
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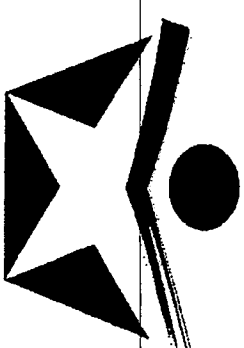
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FNS INSTRUCTION
796-2, Rev. 3

18

GLOSSARY

*This is the eighteenth in a series of brochures
on FNS Instruction 796-2, Revision 3.*

The following terms are frequently used in FNS Instruction 796-2, Rev. 3. Refer to Exhibit A of the Instruction for a more detailed Glossary.

Acquisition cost is the net invoice price of a purchased item.

Administrative costs result from planning, organizing and managing a food service under the Child and Adult Care Food Program (CACFP).

Affiliated center is a center that is owned, in whole or in part, by a CACFP sponsoring organization.

Applicable credits offset or reduce direct and indirect expenses.

Compensatory time is paid leave granted in lieu of a cash payment for overtime or holiday work.

Cost means an amount determined on a cash or accrual basis.

Depreciation is the expense associated with the use of property owned by the institution.

Direct costs are identified specifically with a particular cost objective.

Direct expensing means, instead of charging depreciation, the cost of equipment, other property and certain modifications or repairs is charged at the time the item is purchased or the modification/repair is made. Direct expensing is also called a capital expenditure.

Durable supplies have a life expectancy of more than one year and an acquisition cost of less than \$5,000 per unit.

Equipment has a useful life of more than 1 year and an acquisition cost of \$5,000 or more per unit.

Expendable personal property is all tangible personal property other than nonexpendable personal property.

Financial management is the effective control over, and accountability for all funds, property and other assets to assure that they are safe-guarded and used efficiently to fulfill Program requirements.

Holiday pay is earned for work performed on a recognized non-work holiday.

Indirect costs are incurred for a common or joint purpose.

A less-than-arms-length transaction is one under which one party is able to control or substantially influence the actions of the other(s).

Nonexpendable personal property is all property with a useful life of more than 1 year and an acquisition cost of \$5,000 or more.

Nonprofit food service includes all food service operations conducted by the institution principally for the benefit of enrolled participants, from which all of the Program reimbursement funds are used solely for the operation or improvement of that food service.

Operating costs result from serving meals to participants.

Overtime compensation is earned for work performed in excess of an employee's regular work schedule.

Participant is an eligible child or adult, as defined in 7 CFR 226, who participates in the CACFP.

Prior approval means securing the State agency's or, in some cases, FNS' permission in advance to incur costs. Except in cases of emergencies, this permission must be in writing.

Program when capitalized (Program) means the CACFP. When lower cased, (program) means the food service conducted primarily for the benefit of enrolled participants.

Program costs are allowable nonprofit food service operating and administrative costs.

Prudent person is a standard used to evaluate whether a sensible person exercising due care would spend the same amount of money on the item or activity in question.

Related party transaction occurs between the institution and its parent corporation, corporate divisions, subsidiaries, an employee(s), officer(s), or agent(s) of the institution or members of their immediate family, either directly or indirectly.

Shared costs are direct costs that benefit more than one cost objective and can be easily prorated. Shared costs are also referred to as joint costs.

Supplies are items other than equipment and real property.

Unaffiliated center is legally distinct from its sponsoring organization.

Unfunded cost is the difference between the amount of cost incurred and the funds available to pay the cost.

Use allowance is used to recognize the value of property that has been fully depreciated on the institution's books before being placed into service in a Federally funded program. The maximum use allowance for buildings and improvements is 2 percent. For equipment, it is 6²⁹ percent.

NOTE: Additional requirements may apply. Consult 796-2, Rev. 3 and the appropriate administering agency for more information.